No. 14-400

In The
Supreme Court of the United States

CHARLES E. HARRIS, III,

Petitioner,

v.

MARY K. VIEGELAHN, Chapter 13 Trustee,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF OF THE NATIONAL ASSOCIATION OF CHAPTER THIRTEEN TRUSTEES AS *AMICUS CURIAE* SUPPORTING RESPONDENT

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INTEREST OF THE *AMICUS CURIAE*

The National Association of Chapter Thirteen Trustees ("NACTT") is a non-profit, educational organization composed of consumer bankruptcy professionals.[1] Its membership represents a broad spectrum of participants in the consumer bankruptcy process including debtors' attorneys, creditors' representatives, and chapter 13 standing trustees. The NACTT's voting membership is composed of private trustees appointed by the U.S. Department of Justice, Executive Office of the U.S. Trustee, *see* 28 U.S.C. § 586, and in the federal judicial districts of North Carolina and Alabama by the judiciary. Approximately 98% of the chapter 13 standing trustees in the United States are voting members of the NACTT. Robert B. Wilson, a Chapter 13 Standing Trustee for the Northern District of Texas and current president of the NACTT, and the NACTT's Board of Directors, have directly authorized Henry E. Hildebrand, III, Chapter 13 Standing Trustee for the Middle District of Tennessee, to

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[1] Both the petitioner and the respondent have consented to the filing of this brief. Copies of the parties' letters consenting to the filing of this brief have been filed with the Clerk. No counsel for a party authored this brief in whole or in part and neither counsel for a party nor any party made a monetary contribution intended to fund the preparation or submission of the brief. The NACTT is a non-profit association and has used its own resources in preparing this brief. The respondent, as a member of the NACTT, pays general dues to the organization but has not provided any direct monetary contribution to support the preparation or submission of this brief.

prepare and submit this *amicus curiae* brief on the NACTT's behalf.

Historically, Congress and federal courts have observed that the more efficient and effective chapter 13 programs are those conducted by chapter 13 standing trustees who exercise a broad range of responsibilities in both the design and effectuation of chapter 13 plans. *See Matter of Maddox*, 15 F.3d 1347, 1355 (5th Cir. 1994). A chapter 13 trustee has a statutory responsibility to participate in the confirmation and administration of every chapter 13 plan. *See* 11 U.S.C. § 1302. A chapter 13 trustee, like bankruptcy trustees in general, is charged with a responsibility to the system and to maximize recoveries to creditors. The trustee is empowered to assert claims, avoid preferences and fraudulent transfers, collect property of the estate, and examine and object to creditors' claims in furtherance of the congressional goal of equitably distributing property of the estate to holders of allowed claims. *Maddox*, 15 F.3d at 1355; *In re Gustav Schaeter Company*, 103 F.2d 237 (6th Cir. 1939). The trustee represents the interests of all creditors collectively by exercising various powers to ensure that the collection of the debtor's disposable income and disbursement of that money to creditors pursuant to a confirmed plan occurs according to the dictates of Congress, as set forth in title 11 of the United States Code (the "Bankruptcy Code"). *Maddox*, 15 F.3d at 1355.

The NACTT's perspective is important, as the direct holding in this case will affect the practice of

every chapter 13 trustee. The NACTT's members also have the expertise to offer meaningful assistance in presenting the issues to the Court. They specialize in this area and their experience gives the organization particular insight into the practical issues the case presents.

SUMMARY OF THE ARGUMENT

The Bankruptcy Code provides direct guidance on the issue presented by this case. Section 1326 governs chapter 13 plan payments. The first paragraph of that section sets out the requirement that the debtor commence making payments under the plan to the trustee. 11 U.S.C. § 1326(a)(1)(A). The second paragraph instructs trustees regarding the disposition of plan payments and includes the following two sentences: "A payment made under paragraph (1)(A) shall be retained by the trustee until confirmation or denial of confirmation. If a plan is confirmed, the trustee *shall* distribute *any such payment* in accordance with the plan as soon as is practicable." 11 U.S.C. § 1326(a)(2) (emphasis added). The phrase "any such payment" in the second sentence is open to two interpretations. It might, as some courts have held, refer back to any payment retained by the trustee pursuant to the first sentence, making it a reference only to pre-confirmation payments. But this interpretation would leave a gap. The statute would provide specific guidance regarding pre-confirmation payments, but none regarding post-confirmation

payments. The phrase "any such payment," however, might also refer back to the *kind* of payment that the first sentence concerns – payments under the plan, as required by § 1326(a)(1)(A). The context supports this interpretation, as it leaves no statutory gap, and as the resulting mandate is exactly what one would expect. It gives trustees the same instruction for post-confirmation plan payments as for pre-confirmation plan payments when the court has confirmed a plan – to disburse the funds in accordance with the confirmed plan.

Even if § 1326 did not provide this mandate, the nature of the chapter 13 process would dictate the same result. Confirmation of a plan is a dividing line in a chapter 13 case. The statute provides some breathing room to debtors seeking confirmation, directing trustees to return plan payments to debtors if the court does not confirm a plan, subject to some exceptions. *See* 11 U.S.C. § 1326(a)(2). But the confirmation of a plan makes the plan binding on debtors and creditors, *see* 11 U.S.C. § 1327(a), and permits the fixing of rights under the plan.

Plainly, rights with regard to chapter 13 plan payments can become fixed *during* the chapter 13 case. The petitioner does not take a contrary position. He recognizes that creditors' rights vest during the case, but he argues that the vesting occurs only when the trustee has actually distributed funds. The nature of the chapter 13 arrangement, however, suggests that the *debtor's* rights to plan payments under a confirmed chapter 13 plan terminate in favor of the

creditors under the plan upon submission of the payments to the trustee even if creditors' rights do not vest until distribution. Multiple aspects of the chapter 13 process support this conclusion.

First, when a case involves a confirmed plan, the debtor's submission of plan payments represents the fulfillment of a binding obligation. A debtor's decision to proceed with a confirmed chapter 13 plan is voluntary, but the debtor's obligations while the plan is in effect are not. The debtor has the power to terminate a plan at virtually any time, but the termination only has a prospective effect with regard to the debtor's payment obligations. An attempt to recapture payments already due and made to the trustee under a confirmed plan denies the binding effect the plan had at the time the payments were made.

Second, chapter 13 plan payments are the price of relief under chapter 13. The relief available under chapter 13 differs from the relief available under chapter 7. Debtors realize some of the benefits immediately, such as the extended protection under the automatic stay and the ability to retain property of the estate that would be lost in a chapter 7. The plan, of course, also involves other relief, like the discharge, that debtors do not realize immediately. But the plan payments are not refundable merely because they go toward both present and future relief. The debtor bears the burden, with each plan payment, of determining whether the benefits of the plan – immediate and potential – justify continuing with the plan and incurring the cost.

Many of the benefits a debtor realizes during a chapter 13 case come at the expense of creditors bound by the confirmed plan, and the conversion of the debtor's case does not generally reverse these costs. The distributions under the plan provide the only compensation the creditors receive for these costs. The petitioner significantly overstates the degree to which distributions under a chapter 13 plan benefit creditors in relation to chapter 7. Though debtors generally fund chapter 13 plans from post-petition income that would not be included in a chapter 7 estate, the distributions also purchase rights that the chapter 7 case does not provide. For example, secured creditors often receive distributions in chapter 13 cases that they would not receive from a chapter 7 case, but the creditors' liens also survive the chapter 7 case. For a debtor to retain collateral after a chapter 7 case in the same way the debtor retains collateral during a chapter 13 case, the debtor would have to make payments from non-estate funds. For some debtors, moreover, the comparison to chapter 7 is simply inapposite because the chapter 7 means test would preclude a chapter 7 case. *See* 11 U.S.C. § 707(b).

Third, debtors relinquish their claim to funds by remitting them to the chapter 13 trustee. The sole purpose of remitting payments to the trustee is to convey funds to creditors. *See* 11 U.S.C. § 1322(a)(1). The delay between the trustee's receipt of plan payments and the disbursement of funds to creditors is

not related to the debtor's retention of any rights to the funds.

The petitioner argues that § 348(f) controls the disposition of undisbursed plan payments upon conversion because, absent bad faith, it excludes post-petition income from the property of the estate in the converted chapter 7 case. But the basis for distributing funds held by a chapter 13 trustee to creditors under a confirmed plan is not that the funds are included in the chapter 7 estate. It is not even that the funds are or were property of the chapter 13 estate. *See* 11 U.S.C. § 1322(b)(8) (permitting a plan to provide for payment of "all or any part of a claim . . . from property of the estate *or property of the debtor*" (emphasis added)). Rather, the basis for distributing funds to creditors is that the confirmed plan established rights with respect to the funds prior to the conversion.

The respondent's position does not conflict with the general congressional support for chapter 13. Congress favors chapter 13 because it promises better results for both debtors *and creditors*. Even if a policy of returning funds to debtors upon conversion would encourage chapter 13 filings, it would not serve the congressional policy if it did so only by favoring debtors over creditors. Further, the respondent's position far from eliminates the incentives to file chapter 13 over chapter 7. These incentives include a broader discharge under chapter 13, a right to the return of plan payments when a plan is not confirmed, and the possibility of subjecting post-petition claims to

discharge in a conversion to chapter 7 without submitting post-petition assets to the chapter 7 estate.

The rights with respect to chapter 13 plan payments derive from the confirmed plan, so the confirmed plan should control the disposition of the funds, not because the plan remains effective after conversion but rather because the effectiveness it had prior to the conversion is not undone by the conversion. The Fifth Circuit held that payments under a confirmed plan do not give creditors any "vested rights to payment" but, based on considerations of policy and equity, concluded that creditors have a claim to funds that is superior to that of the debtor. Pet. App. 22a-28a. Though the court's opinion suggests that the confirmed plan would control the distributions to creditors, the holding is stated in terms of relative rights between creditors and debtors. The NACTT urges this Court to affirm the Fifth Circuit's holding that creditors have a superior claim to undistributed plan payments under a confirmed chapter 13 plan but also to make clear that the confirmed plan guides the distribution of the funds.

ARGUMENT

I. Section 1326(a)(2) directs a chapter 13 trustee to disburse plan payments in accordance with a confirmed plan

Section 1326(a)(2) provides direct statutory guidance regarding the disposition of plan payments

made to a chapter 13 trustee. It controls the disposition of funds even if a case is converted or dismissed before the trustee actually disburses the funds. *See, e.g.*, *In re Michael*, 699 F.3d 305, 314 n.7 (3d Cir. 2012) ("[I]f a Chapter 13 proceeding is converted pre-confirmation administrative expense claims will be paid from undistributed plan payments. . . ."); *In re Parrish*, 275 B.R. 424, 430 (Bankr. D.D.C. 2002) ("[T]he chapter 13 trustee disburses to creditors in accordance with the confirmed plan any undisbursed plan funds held at the moment of either a dismissal or a conversion."); *Waugh v. Saldamarco* (*In re Waugh*), 82 B.R. 394, 400 (Bankr. W.D. Pa. 1988) ("The word 'shall' in section 1326(a)(2) creates the condition of a trust. Creditors have a right to the funds in an active confirmed chapter 13 plan upon payment by the debtor.").

Section 1326(a)(2) reads as follows:

> A payment made under paragraph (1)(A) shall be retained by the trustee until confirmation or denial of confirmation. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan as soon as is practicable. If a plan is not confirmed, the trustee shall return any such payments not previously paid and not yet due and owing to creditors pursuant to paragraph (3) to the debtor, after deducting any unpaid claim allowed under section 503(b).

11 U.S.C. § 1326(a)(2). Some courts, including the Fifth Circuit below, read the phrase "any such payment" in

the second sentence as a reference to any payments retained by a trustee pursuant to the instruction in the first sentence, making it a reference only to pre-confirmation plan payments. *See, e.g.*, *Williams v. Marshall* (*In re Williams*), 488 B.R. 380, 385 (Bankr. N.D. Ill. 2013); *see also* Pet App. 15a; Pet. Br. 33 n.8 (compiling cases). This interpretation, however, is not the only possibility. The phrase, instead, might serve as a reference back to the *kind* of payment that the first sentence concerns. *See* Bryan A. Garner, *Garner's Modern American Usage* 783 (3d ed. 2009) ("[*S*]*uch* means 'of that kind'. . . . It isn't properly equivalent to *this*, *that*, *these*, or *those*."). The subject of the passive-voice first sentence is "a payment under paragraph (1)(A)" – that is, a payment under the plan. Under this interpretation, the phrase "any such payment" functions as a reference to plan payments generally, and the three sentences in § 1326(a)(2) represent a succeeding set of instructions with regard to plan payments: The first sentence says plan payments shall be retained by the trustee until confirmation or denial of confirmation. The second sentence says that *any* plan payment (whether pre-confirmation or post-confirmation) shall be distributed in accordance with the plan if a plan is confirmed. The third sentence says plan payments shall be returned to the debtor, with specified exceptions, if a plan is not confirmed.

The broader context supports this interpretation. The contrary interpretation is certainly possible as a matter of grammar and usage, but it leaves a glaring

gap in the statute. Under that interpretation, the Code would provide specific guidance regarding the disposition of pre-confirmation payments, but it would provide no guidance regarding post-confirmation payments. The interpretation advanced here fills that gap with an entirely predictable instruction for the disposition of post-confirmation plan payments, the same instruction the Code gives for the disposition of pre-confirmation plan payments under a confirmed plan.

The petitioner contends that § 1326 is inapplicable upon conversion because § 103(i) specifies that chapter 13 applies only in cases under that chapter. This exceedingly literal application of § 103(i) is not consistent with § 1326. Section 1326, for example, instructs chapter 13 trustees to make disbursements on administrative claims (claims under § 503(b)) if the court denies confirmation. Under the petitioner's interpretation, chapter 13 trustees would not have the authority to make these disbursements in cases that convert to another chapter. This result would create an inexplicable disparity between cases that are converted and cases that are dismissed prior to confirmation. The petitioner's interpretation also would invalidate the provision of § 1326 that instructs the chapter 13 trustee to return funds to the debtor. The better view is that § 1326 governs because it was effective at the time the trustee received the funds – that rights with regard to the plan payments become fixed pursuant to chapter 13 prior to conversion to another chapter.

The petitioner's argument that § 348(e) eliminates the chapter 13 trustee's role upon conversion suffers from a similar flaw. The trustee's duty to return funds to a debtor in a case that is converted pre-confirmation is a duty as trustee, not just as a private individual who finds himself or herself in possession of the debtor's property. *See Parrish*, 275 B.R. at 431 ("[Section] 348, in terminating the chapter 13 trustee's services so that she does not continue to serve as a trustee administering the chapter 7 estate, does not relieve the chapter 13 trustee of her duty that existed preconversion to make distribution as commanded by § 1326(a)(2)."). For example, a loss of funds held by a trustee after a conversion from chapter 13 presumably would implicate the bond the trustee was required to file with the court "conditioned on the faithful performance of [the trustee's] official duties." 11 U.S.C. § 322(a).

II. Creditors have rights to funds remitted to the trustee under a confirmed chapter 13 plan that are superior to the debtor's rights upon conversion to chapter 7

Even if § 1326(a)(2) were not controlling, the nature of the chapter 13 process would dictate that creditors have rights to funds remitted to the trustee under a confirmed chapter 13 plan that are superior to the debtor's rights upon conversion to chapter 7. Section 348 does not demand a different result.

A. The debtor's submission of plan payments to the trustee under a confirmed chapter 13 plan fulfills a binding obligation

A debtor's principal obligation under a chapter 13 plan is to make the payments required by the plan, and the plan payments are the price the debtor pays to proceed under chapter 13. Prior to confirmation, § 1326 makes these payments partially contingent by providing for the return of funds if a plan is not confirmed. *See* 11 U.S.C. § 1326(a)(2). But confirmation formalizes the plan and makes its set of rights and responsibilities fully binding on debtors and creditors alike. *See* 11 U.S.C. § 1327(a). It becomes a "legislatively sanctioned, and judicially approved new series of rights and responsibilities among the debtor and the debtor's creditors." *Ledford v. Burns* (*Matter of Burns*), 90 B.R. 301, 304 (Bankr. S.D. Ohio 1988). The confirmed plan provides the path to an eventual discharge (when the debtor is eligible for a discharge), but it also establishes interim rights and responsibilities that may become fixed during the chapter 13 case. When the court confirms a plan, the debtor's submission of payments required by the plan represents the fulfillment of a binding obligation, and nothing suggests that the payments are refundable.

The petitioner seeks to extend the pre-confirmation treatment of plan payments past the dividing line of confirmation. He argues that post-conversion distributions to creditors "penalize" the debtor because payments distributed after a conversion no longer

apply toward the goal of a chapter 13 discharge. Even if the implied premise of this argument – that debtors receive no meaningful benefit from an aborted chapter 13 case – were correct, it ignores the debtor's binding obligations under the plan. The petitioner's argument, moreover, would apply to *all* payments under a chapter 13 plan, including payments that a trustee has disbursed to creditors pre-conversion. If, as the petitioner suggests, Congress intended to permit good-faith debtors to retroactively select chapter 7 without "penalty" – obtaining the exact result they would have obtained if they had initially filed under chapter 7 – then debtors in converted cases would be entitled to a return of the payments distributed to creditors pre-conversion. *See Mehan v. Sparkman* (*In re Mehan*), Nos. 96-11385 DWS, 00-0002, 2000 WL 1010577, at *4 (Bankr. E.D. Pa. July 19, 2000); *cf. In re Parrish*, 275 B.R. 424, 433 (Bankr. D.D.C. 2002) (responding to a similar argument regarding the effect of dismissal). This result would be entirely unworkable and unfair to creditors that were subject to the restrictions of an active chapter 13 plan prior to the conversion.

Plainly, rights with regard to chapter 13 plan payments can become fixed *during* the chapter 13 case. The petitioner does not dispute this conclusion, despite his view that the post-conversion distribution of funds represents a penalty. He only disputes the timing. He addresses the issue in terms of the vesting of creditors' interests, and he contends that this vesting occurs only when the trustee distributes the

funds. Pet. Br. 33. He cites no statutory provision that directly controls this timing, however, and other than § 1326(a)(2)[2] the statute does not expressly provide *at all* for either the termination of a debtor's interests in plan payments or the vesting of creditors rights to funds. Clearly, however, rights to plan funds become fixed as a confirmed chapter 13 plan proceeds. Some courts hold that that creditors' rights "vest" upon receipt of funds by a chapter 13 trustee. *See* Resp. Br. 23 n.4 (compiling cases). But the Court of Appeals below correctly concluded that the creditors need not hold "vested rights" to funds in order to have claims to the funds that are superior to the debtor's. *See* Pet App. 28a. The NACTT submits that, in general, a *debtor's* rights to plan payments terminate when the debtor relinquishes funds to the trustee under a confirmed plan. *See, e.g.*, *In re Radenbaugh*, 125 B.R. 797, 798 (Bankr. W.D. Mo. 1991) ("The payment of the money to the Chapter 13 Trustee once the plan is confirmed is equivalent to paying the money to the creditors."); *Waugh v. Saldamarco* (*In re Waugh*), 82 B.R. 394, 400 (Bankr. W.D. Pa. 1988) (holding that property a trustee

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[2] Even if § 1326(a)(2) governed only pre-confirmation payments, it would demonstrate the possibility of rights to plan payments becoming fixed prior to the actual distribution of the funds to creditors. The provision contains language directing a trustee to disburse funds to creditors, and numerous courts have held that these instructions control the disposition of funds even after conversion or dismissal. *See, e.g.*, *In re Michael*, 699 F.3d 305, 314 n.7 (3d Cir. 2012); *In re Inyamah*, 378 B.R. 183, 185 (Bankr. S.D. Ohio 2007).

receives under a confirmed plan constitutes a "trust for beneficiaries of the plan"). The nature of the chapter 13 system and the details of the chapter 13 payment process support this conclusion.

B. Plan payments purchase the bankruptcy relief afforded under chapter 13

The plan payments under a confirmed chapter 13 plan purchase the relief the case affords, and much of the relief comes at the expense of creditors. Permitting debtors to reclaim payments submitted under a confirmed plan would be anomalous, as the debtor has already enjoyed the relief the payments purchase and the payments were already due.[3] From the debtor's perspective, moreover, the payment process is complete once the debtor has submitted the payment to the trustee.

Some of the benefits of a chapter 13 case – most notably, the discharge – do not accrue immediately. But the potential nature of these benefits does not make the debtor's obligations contingent. The Bankruptcy Code makes no guarantee that plan payments toward a potential benefit under a confirmed chapter 13 plan are risk-free. Doing so would shift risks to creditors. For example, a debtor might elect chapter

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[3] The timing of payments under § 1326 suggests that plan payments generally apply retrospectively. Section 1326(a)(1) does not require a debtor to commence plan payments until 30 days after the petition date. *See* 11 U.S.C. § 1326(a)(1).

13 because it allows the debtor to retain a vehicle that secures a debt (and even modify the terms of the debt). *See generally* Keith M. Lundin & William H. Brown, *Chapter 13 Bankruptcy* § 104.1 (4th ed., sec. rev. Jan. 5, 2011), www.Ch13online.com (describing the power to modify secured claims). If the vehicle breaks down during the plan, the plan may no longer hold any advantage over a chapter 7 case for the debtor. The debtor in that situation would be free to terminate the *future* obligations under the plan by converting or dismissing the case, but nothing in the Code suggests that the debtor has the power to retroactively rescind payments submitted prior to the termination.

The petitioner argues that he is entitled to reclaim payments remitted under a binding plan because chapter 13 is voluntary and because subsequent events revealed that the potential benefits of the plan "evaporated." Pet. Br. 45. But because the plan payments represent the fulfillment of binding obligations, the debtor's subsequent determination that the plan is not beneficial does not undo the prior payments. The petitioner's argument is akin to an argument by a purchaser of life insurance that the insurer should refund the policy premium because the insured made no claim on the policy and the benefits of the policy never materialized. The effectiveness of payments made under a confirmed chapter 13 plan stems from the binding effect of the plan at the time the debtor remitted the payments, not from an

after-the-fact determination of the actual benefits the debtor realized.

The very voluntariness of chapter 13 highlighted by the petitioner supports upholding the effectiveness of payments debtors voluntarily remit in order to proceed under chapter 13. *See In re Bell*, 248 B.R. 236, 239-40 (Bankr. W.D.N.Y. 2000) ("Although Chapter 13 is a voluntary proceeding, just because debtors at some point post-confirmation voluntariiy change their intent and elect to proceed in Chapter 7 rather than in Chapter 13, that election does not retroactively revoke the intent they had at the time when they were operating under a confirmed plan and voluntarily chose to make the required plan payments to enable them to continue to enjoy the ongoing benefits of that plan." (footnote omitted)). A debtor has the ability to terminate future obligations under a plan almost immediately. *See* Fed. R. Bankr. P. 1017(f) ("A . . . chapter 13 case shall be converted without court order when the debtors files a notice of conversion."); *see also* 11 U.S.C. § 1307(a), (b). The debtor's voluntary decision to pay the price of continuing with a confirmed plan is binding in large part because the debtor had the choice not to do so.

The petitioner also virtually ignores the tangible benefits chapter 13 debtors receive during the chapter 13 case, more or less contemporaneously with the plan payments:

- A chapter 13 case generally[4] provides an extended period of protection from creditors under the automatic stay. *See generally* Lundin & Brown, *supra,* §§ 68.2, 207.1.
- Chapter 13 also stays creditor actions against codebtors. *See* 11 U.S.C. § 1301.
- A chapter 13 case permits debtors to retain property that might otherwise be subject to liquidation or repossession if the debtor were to proceed under chapter 7.[5]

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[4] In some repeat filings, the Code provides for automatic termination of the stay. 11 U.S.C. § 362(c)(3), (4). Creditors also may seek relief from the automatic stay. 11 U.S.C. § 362(d).

[5] Chapter 13 allows debtors to restructure many secured debts, adjusting interest rates, extending payment schedules, and, in some circumstances, even paying less than the prepetition claim amount. In a chapter 7 case, debtors have more limited options for retaining collateral that secures a claim. They may reaffirm a secured debt but doing so requires the debtor to obtain court approval for a new agreement and to make payments under the agreement to avoid repossession or foreclosure. *See* 11 U.S.C. § 524(c). In some instances, a debtor also has the option of "redeeming" personal property that serves as collateral for a secured claim by paying the holder only the value of the creditor's interest in the collateral. This option, however, requires the debtor to pay the creditor this amount in full at the time of the redemption. *See* 11 U.S.C. § 722. Non-statutory options may also permit debtors to retain collateral, but they likewise require the debtor to make payments on terms that are likely to be less favorable than under chapter 13. *See* Amber J. Moren, *The Economic Case for Ride-Through in the Bankruptcy Code*, 122 Yale L.J. 1594, 1614-17 (2013) (describing "forbearance on repossession" and "backdoor ride-through").

- A chapter 13 case allows debtors to cure defaults and maintain regular payments on long-term secured claims such as mortgages. 11 U.S.C. § 1322(b)(5). This power is not tied to the discharge of the debt or completion of payments under the plan. *See* 11 U.S.C. §§ 348(f)(1)(C)(ii) (referring to the possibility of "fully cur[ing]" a prebankruptcy default prior to conversion), 1328(a)(1) (excluding debts provided for under § 1322(b)(5) from discharge). The petitioner's implied theory of conversion – that the chapter 13 plan is effectively annulled and that § 103(i) makes chapter 13 irrelevant upon conversion to another chapter – would deny this effect.

- A chapter 13 debtor has the ability to pay an attorney through the chapter 13 plan. *See* 11 U.S.C. § 330(a)(4)(B). In a chapter 7 case, a debtor's attorney is more likely to demand payment up front, as the statute does not provide for payment of fees for representing the debtor from the chapter 7 estate. *See Lamie v. U.S. Trustee*, 540 U.S. 526, 534 (2004); *see also Berliner v. Pappalardo* (*In re Puffer*), 674 F.3d 78, 84-85 (5th Cir. 2012) (Lipez, J., concurring) (describing the "*Lamie* problem").

- Chapter 13 permits debtors to manage nondischargeable debts. *See* Lundin & Brown, *supra*, § 4.5, at ¶ 5. This benefit of chapter 13 is, by definition, not

dependent upon an eventual discharge of the debt.

- Chapter 13 permits debtors to manage debts during a period that the debtor is ineligible for a discharge under chapter 7. *See* 11 U.S.C. §§ 727(a)(8), (9). Some debtors, moreover, proceed under chapter 13 even when they will not receive a discharge in the chapter 13 case. *See, e.g.*, *Baxter v. Lewis* (*In re Lewis*), 339 B.R. 814, 817 (Bankr. S.D. Ga. 2006). The fact that debtors elect to do so is virtually irrefutable evidence that debtors perceive benefits from chapter 13 that are not dependent upon a discharge.

The NACTT questions the petitioner's suggestion that "[c]reditors are virtually always better off if a debtor first attempts to proceed under Chapter 13." Pet. Br. 46. The principal benefits that accrue to chapter 13 debtors come at the expense of creditors, and the costs to creditors of the immediately realized benefits are not generally reversed by a conversion to chapter 7. The extended automatic stay prevents creditors from taking actions they would otherwise be entitled to take. They have no power to go back in time and take the actions that the stay precluded. Similarly, secured creditors in a case that converts to chapter 7 receive nothing to compensate for any reduction in their security due to the debtor's retention and use of the collateral. The only protection these creditors have comes from the distributions in the chapter 13 case. *See In re Rutenbeck*, 78 B.R. 912, 913

(Bankr. E.D. Wis. 1987) (noting the unfairness of denying funds to "secured creditors who have been promised these funds and who have relied on them for the protection afforded . . . under § 361(1) of the Code"). Even creditors that chapter 13 ostensibly compensates for the delays in distributions under chapter 13 relative to chapter 7 may come up short in a conversion. A chapter 13 plan must provide for creditors to receive the present value of the amount they would receive in a liquidation under chapter 7, *see* 11 U.S.C. § 1325(a)(4), but the Code does not directly require debtors to pay interest on these claims as it accrues. In many cases, the plan pays other claims first. *See, e.g.*, *In re Redick*, 81 B.R. 881, 885 (Bankr. E.D. Mich. 1987) ("We can take notice that there are occasions where a Chapter 13 case proceeds for some time without any payments being made to general unsecured creditors."). The accumulated interest due to these creditors evaporates if the case converts to chapter 7. The creditors receive, at best, what they would have received if the case had begun under chapter 7, with no compensation for the delay.

The petitioner argues that, because the money that funds a chapter 13 plan is generally post-petition income that would not have been included in the chapter 7 estate if the debtor had filed under chapter 7, the chapter 13 payments made prior to a conversion represent a windfall to creditors. The argument misrepresents the nature of a chapter 13 plan in relation to a liquidation under chapter 7. Secured creditors do not receive distributions from property of

the estate in a chapter 7 case,[6] *see* 11 U.S.C. § 726, but the creditors' liens generally survive the chapter 7 discharge, *see Dewsnup v. Timm*, 502 U.S. 410, 418-19 (1992), meaning that debtors wishing to retain collateral after a chapter 7 case must make payments to secured creditors in some form.[7] Chapter 13 plans, in contrast, frequently provide for payments on secured claims. In fact, payments on secured claims often represent a large portion of the distributions under a chapter 13 plan, especially distributions early in the plan. The distributions to secured creditors under chapter 13 plans do not necessarily (or even generally) represent a windfall relative to what the creditors would have received if the debtor had filed under chapter 7.

The suggestion that payments under a chapter 13 plan represent a windfall to creditors also ignores the fact that a chapter 7 case is not a viable alternative for all debtors. The amendments to the Bankruptcy Code in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 introduced a means test into individual chapter 7 cases designed to deny chapter 7 relief to debtors with a reasonable ability to pay a significant amount to creditors outside of

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[6] If a trustee obtains authority to sell property free and clear of liens, *see* 11 U.S.C. § 363(f), the trustee might make distributions from the sale proceeds on account of a lien, especially if the authority to sell free and clear of the lien derived from § 363(f)(3).

[7] *See supra* note 5.

chapter 7. *See* 11 U.S.C. § 707(b). By closing off the chapter 7 option, means testing encourages debtors to repay creditors through chapter 13 plans. It is unclear from the record whether means testing was a factor in the petitioner's decision to proceed under chapter 13, but the fact that the debtor proposed to pay unsecured creditors in full over 60 months suggests that it was. *See* 11 U.S.C. § 1325(b)(4) (establishing an applicable commitment period of 5 years if a debtor is above the applicable median family income). Chapter 13 involves a complementary "best efforts" test that requires debtors to commit all "projected disposable income" to the plan.[8] *See* 11 U.S.C. § 1325(b)(1)(B). For debtors pushed into chapter 13 by the means test, the chapter 13 plan payments clearly represent the price Congress intended the debtors to pay to obtain bankruptcy relief. If such a debtor experiences a reduction in income during a chapter 13 case, the debtor might be able to convert to chapter 7 and rebut the presumption of abuse under the chapter 7 means test by showing a reduction in income. *See* 11 U.S.C. § 707(b)(2)(B) (permitting rebuttal by demonstrating "special circumstances"). But the subsequent reduction in income would not affect the past ability to pay or the resulting amount

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[8] For above-median-income debtors, the link to the chapter 7 means test is especially clear, as the projected-disposable-income test for these debtors directly incorporates elements of the chapter 7 means test. *See* 11 U.S.C. § 1325(b)(3).

that Congress clearly believed the debtor should have been paying.

C. Debtors relinquish funds to creditors under a confirmed chapter 13 plan when they remit plan payments to the trustee

The details of the chapter 13 payment process add further support to the conclusion that a debtor's rights to payments under a confirmed chapter 13 plan terminate at the point the debtor makes the payments to the chapter 13 trustee. The trustee in a chapter 13 case (upon confirmation) is essentially a conduit for payments to creditors. The sole purpose of remitting plan payments to the trustee is to convey funds to creditors in accordance with the plan. *See* 11 U.S.C. § 1322(a)(1) (requiring a chapter 13 plan to "provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary *for the execution of the plan*" (emphasis added)). At the point the debtor has made a payment to the trustee, the debtor has relinquished the debtor's claim to the funds and has nothing further to do to complete the payment. *See, e.g.*, *In re Lennon*, 65 B.R. 130, 136 (Bankr. N.D. Ga. 1986) ("[T]he debtor's right of possession [under § 1306(b)] and vesting of title [under § 1307(c)] is limited to all sums and property not otherwise provided for in the confirmed plan or confirmation order. These exceptions to possession and vesting of title in debtor indicate that debtor is to

have no continuing interest in payments actually made pursuant to a confirmed plan.").

The timing of the trustee's conveyance of funds to creditors is often a matter of administrative practicality; a trustee would have authority to disburse most payments to creditors continuously and immediately. *See In re Hardin*, 200 B.R. 312, 313 (Bankr. E.D. Ky. 1996) ("[A]dministratively it is not possible to make a distribution upon receipt of each payment and often some accumulation will occur . . . prior to the making of a distribution to creditors."); *In re Redick*, 81 B.R. 881, 886 (Bankr. E.D. Mich. 1987) ("Had daily distribution been the practice, the question involved in these cases would never have arisen since no undistributed funds would ever have existed when these cases converted to Chapter 7."). In fact, some trustees do make disbursements more frequently than others. *See In re Michael*, 699 F.3d 305, 316 (3d Cir. 2012) (noting that "some trustees make plan disbursements twice a month, while some only once a month"). An entirely practical delay between the receipt of a payment by a trustee and the disbursement of funds to creditors is not a sound basis for determining substantive rights to the funds. *Waugh v. Saldamarco* (*In re Waugh*), 82 B.R. 394, 400 (Bankr. W.D. Pa. 1988) ("The speed by which the chapter 13 trustee makes distribution should not determine the rights of creditors and debtors in the funds."). Even when the delay relates to substantive rights, it concerns the *creditors'* relative rights to the funds, not the debtor's rights. *See, e.g.*, *In re Pegues*, 266 B.R.

328, 337 (Bankr. D. Md. 2001) (granting a chapter 13 trustee's motion to disallow a claim as abandoned and authorizing the trustee to re-distribute the funds to other creditors after the case had converted to chapter 7).

Indeed, the facts of the case below emphasize the insubstantiality of a debtor's claim to funds remitted to the trustee. The petitioner made payments under the plan for approximately a year after the bankruptcy court granted stay relief to the mortgage creditor and during that time took no action to prevent the trustee from disbursing the plan payments to other creditors under the plan. (The record does not reveal why the debtor continued to make payments under the plan if the debtor did not intend to submit the funds to creditors.) The trustee had the authority to make these disbursements at any point during this time and had no obligation to hold funds at all. (The trustee apparently held the funds in order to provide the debtor an opportunity to respond to the grant of relief from the stay.[9] Resp. Br. 10.) A trustee's

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[9] "[A] creditor's claim or security is not finally determined in the relief from stay proceeding." *Veal v. Am. Home Mortg. Servicing, Inc.* (*In re Veal*), 450 B.R. 897, 914 (B.A.P. 9th Cir. 2011). The stay relief simply freed the mortgage creditor to pursue other remedies, such as foreclosure, outside of the bankruptcy process. The stay relief, in other words, would not necessarily have precluded a subsequent modification of the plan to resume payments to the creditor (perhaps on a modified loan or providing for the cure of a post-petition arrearage). *See* 11 U.S.C. § 1329.

temporary retention of funds simply provides no indication that the debtor retains rights to the funds.

III. Section 348(f) does not control the disposition of plan payments held by a chapter 13 trustee upon conversion to chapter 7

The petitioner frames the issue in this case in terms of the property of the estate. Contending that the plan payments held by a trustee prior to distribution to creditors represent property of the chapter 13 estate, the petitioner reasons that, upon conversion to chapter 7, the question is whether the funds are included in the chapter 7 estate. The NACTT submits, however, that the termination of a debtor's rights to plan payments under a confirmed chapter 13 plan occurs without regard to whether the plan payments represent property of *either* the chapter 13 estate or the chapter 7 estate.

A chapter 13 case revolves around the confirmation of a plan, not the determination of the property of the estate. (In fact, courts have struggled to develop a coherent theory of the chapter 13 estate.[10]) The property of the estate in a chapter 13 case is not irrelevant. For example, it affects the confirmation requirement that the chapter 13 plan provide for creditors to receive the present value of the amounts

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[10] *See generally* Resp. Br. 37 n.8.

they would receive in a chapter 7 liquidation.[11] *See* 11 U.S.C. § 1325(a)(4). But neither the effectiveness of a debtor's commitment of payments to the plan in exchange for its benefits – potential and immediate – nor the creditors' rights to the payments under the plan are dependent upon the determination of the property of the chapter 13 estate. Chapter 13 plan payments need not even come exclusively from property of the estate. *See* 11 U.S.C. § 1322(b)(8) (stating that a chapter 13 plan may "provide for the payment of all or part of a claim against the debtor from property of the estate or *property of the debtor*" (emphasis added)); *Hagel v. Drummond (In re Hagel)*, 184 B.R. 793, 798 (B.A.P. 9th Cir. 1995) ("Section 1322(b) allows a debtor to make plan payments from exempt property.")[12]; *see also Freeman v. Schulman (In re*

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[11] Property of the estate is also relevant in post-confirmation modifications. Section 1329 incorporates the requirements of § 1325(a), including § 1325(a)(4). 11 U.S.C. § 1329(b)(1). Even though post-petition assets would not necessarily have been included in a liquidation under chapter 7, "a majority of reported decisions fix the effective date for best-interests-of-creditors-test purposes at modification as the effective date of the plan as modified." Keith M. Lundin & William H. Brown, *Chapter 13 Bankruptcy* § 254.1, at ¶ 11 (4th ed., sec. rev. June 15, 2004), www.Ch13online.com.

[12] The ultimate holding of the *Hagel* case was that courts must consider social security income in determining a chapter 13 debtor's projected disposable income under § 1325(b). The 2005 amendments expressly exclude social security income from the "current monthly income" in the disposable income calculation. *See* 11 U.S.C. § 101(10A)(B). But this statutory change does not affect the court's preliminary conclusion regarding § 1322(b)(8).

Freeman), 86 F.3d 478, 481 (6th Cir. 1996) (concluding that the projected-disposable-income determination under § 1325(b) "does not turn in any way on whether the income was 'exempt' "). When a debtor submits funds that are not property of the estate (such as funds that the debtor has exempted from the estate under § 522), a trustee plainly has the authority to distribute the funds in accordance with the plan, and creditors plainly obtain rights to the funds through the plan.

Section 348(f) is not controlling in this case because it only addresses the determination of property of the estate in the converted case. The respondent does not argue, and the Fifth Circuit did not conclude, that creditors have rights to undistributed funds because the funds are included in the chapter 7 estate. The question of the fixation of rights under a confirmed plan does not turn on this issue. The Fifth Circuit's interpretation of § 348(f), moreover, hardly makes it superfluous. As the court explained, § 348(f) still clearly controls the disposition of post-petition assets not already relinquished to creditors under a chapter 13 plan, including not only the unanticipated windfalls involved in the cases cited in the congressional history of § 348(f), *see* H.R. Rep. No. 103-835, at 57 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3366, but also post-petition income not turned over to the trustee for distribution to creditors under the chapter 13 plan.

IV. The respondent's position is not contrary to the congressional policy of supporting chapter 13

The petitioner contends that disbursing payments under a confirmed plan after conversion is inconsistent with congressional support for chapter 13. But this argument ignores the reason Congress supports chapter 13 and discounts the significant incentives the Code does provide to encourage chapter 13 cases.

Congress supports chapter 13 in large part because it promises a benefit to *creditors* in addition to debtors. Amendments to the Bankruptcy Code in 2005, in fact, push debtors with an ability to pay into chapter 13 precisely because chapter 13 promises a better return to creditors. *See supra* Part II.B. (describing the chapter 7 means test). The congressional policy of supporting chapter 13, therefore, does not translate into support for a rule that encourages chapter 13 simply by favoring debtors at the expense of creditors.

The respondent's position, moreover, far from eliminates the Bankruptcy Code's encouragement of chapter 13. For example, a chapter 13 discharge is still "broader than the discharge received in any other chapter." *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 268 (2010) (quoting 8 *Collier on Bankruptcy* ¶ 1328.01, p. 1328-5 (rev. 15th ed. 2008)) (internal quotation marks omitted). And § 1326(a)(2) even provides the type of incentive the debtor suggests is necessary. It gives debtors breathing room to

attempt to obtain confirmation of a plan with limited risk, directing trustees to return plan payments to debtors (subject to some exceptions) if the court does not confirm a plan. 11 U.S.C. § 1326(a)(2). Section 348 also includes powerful incentives to attempt chapter 13 regardless of whether debtors are entitled to a refund of plan payments. Absent bad faith, § 348(f) provides that the property of the estate in a case that converts from chapter 13 to chapter 7 includes only the property of the estate, "as of the date of the filing of the petition, that remains in the possession of or is under the control of the debtor on the date of the conversion." 11 U.S.C. § 348(f)(1)(A). Property that diminishes in value or exits the estate during the chapter 13 case, therefore, is lost to creditors, even if the debtor had the benefit of the property during the chapter 13 case. Further, § 348(d) provides that post-petition, pre-conversion claims are included in the converted chapter 7 case, meaning that, absent bad faith, a debtor is entitled to discharge post-petition debt by submitting only pre-petition assets to liquidation.

V. The creditors' rights to plan payments made under a confirmed chapter 13 plan derive from the binding plan

The Fifth Circuit rejected the argument that specific creditors obtain a vested right to payment, holding instead that the creditors as a whole have a claim to undistributed funds at conversion that is superior to the debtor's. Pet. App. 28a. The NACTT

agrees with the thrust of the Fifth Circuit's decision – that the nature of the chapter 13 process gives creditors a claim to funds remitted to the trustee that is superior to the debtor's claim to the funds, even after conversion. But the NACTT urges the Court to clarify that the creditors' rights derive from the binding effect of the confirmed plan and that the plan, therefore, guides the distribution of plan payments held at conversion.

The NACTT does not dispute the Fifth Circuit's conclusion that the rights of *specific* creditors do not vest immediately upon trustee receipt. A trustee, for example, may hold funds pending the outcome of a claim dispute. *See, e.g.*, *In re Hufford*, 460 B.R. 172, 180-81 (Bankr. N.D. Ohio 2011). In that situation, the creditors as a whole have a claim to the funds that is superior to the debtor's, but the determination of the *specific* creditors' rights is subject to change prior to the actual distribution of the funds. The Fifth Circuit, however, did not provide clear guidance for determining the details of the creditors' "superior" claim to the undistributed funds. The court based its decision on considerations of policy and equity, Pet. App. 22a-28a, and though the opinion suggests that these considerations support distributions in accordance with the confirmed plan, the court did not state so directly. (Some of the confusion in this case may stem from the court's apparent conclusion that distributions in accordance with the confirmed plan would have required distributions to the mortgage creditor. *See* Pet. App. 17a. The NACTT, however, would submit that

the distributions the trustee made were consistent with the confirmed plan.[13]) The NACTT urges the Court to clarify that the creditors' rights to funds held by a chapter 13 trustee under a confirmed plan represent the rights to distributions in accordance with the confirmed chapter 13 plan. A holding that creditors' rights depend on a case-specific balancing of policy and equity would put trustees in the impossible position of having a duty to disburse funds to creditors but no instructions for making these disbursements.

CONCLUSION

For the foregoing reasons, the NACTT requests that the Court affirm the decision of the Court of Appeals but clarify that chapter 13 trustees have the

[13] In concluding that rights to plan payments do not vest in *specific* creditors, the court noted that, "if a right to [the undistributed] funds had vested specifically in Chase (the original intended recipient) when Harris made his payments to Viegelahn, the other creditors would have no right to them." Pet App. 17a. The plan, however, did provide for the trustee to "stop any further payment on [a] claim" upon entry of an order lifting the automatic stay. JA 32. The plan also accommodated the possibility of non-payment on any given claim by providing for available funds to flow to other creditors. *See* JA 28 ("Once Debtor's attorney fees are paid in full, those funds [apparently referring to funds remitted to the trustee] will be paid, pro rata, first to secured creditors, then to priority creditors and then to unsecured creditors."). The trustee's disbursement of funds, therefore, appears consistent with the confirmed plan.

authority to disburse pre-conversion payments in accordance with a confirmed chapter 13 plan.

Respectfully submitted,

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